Supreme Court of the United States

No. . October Term, 1940.

THE CITY OF NEW YORK,
Petitioner,

against

THE UNITED STATES OF AMERICA and WAYNE C. TRACE as assignee for the Benefit of Creditors of Long Island Sash & Door Corporation.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

The case involves the application of U. S. R. S. § 3466 to claims arising in the United States of America out of the activities carried on by the Federal Housing Administrator. A bank creditor of the insolvent (of whom respondent Trace is assignee for benefit of creditors), having had the notes of insolvent held by it insured under the National Housing Act (see Petition, par. 13), assigned these notes after default to the United States of America. Claims for the unpaid balance were filed with respondent Trace by the United States, and priority asserted for them. Claims were also filed for emergency taxes owing by the insolvent to your petitioner, and priority asserted for them. As to each class, the claimed priority was granted, but the United States was given a superior priority in deference to what the Court of Appeals thought to be the requirements of U. S. R. S. § 3466.

Whether, considering the purposes for which the National Housing Act was passed—the relief of unemployment in the building trades—§ 3466 should have been held applicable, is the question presented. No other basis for the government's priority than this statute exists. *United States* v. *State Bank of North Carolina*, 6 Peters 29, 35 (1832).

1. Priority under § 3466 should be denied where, because of the commercial character of the transaction giving rise to the claim, an award of priority would be unjust.

The large group of cases decided in the decade following the close of the first World War reveal a reluctance on the part of this Court to permit the federal government, engaged in commercial ventures, to claim priorities which other creditors of insolvents would not enjoy. Thus in *Mellon* v. *Michigan Trust Co.*, 271 U. S. 236 (1926), this Court denied priority to the claim of the Director General of Railroads for transportation charges and for the conversion of goods shipped, saying (p. 239):

> "In some matters, at least, under § 10, the United States stand exactly as if they were a railroad corporation operating as a common carrier. *Director General* v. *Kastenbaum*, 263 U. S. 25, 28. As said in *Davis* v. *Pullen*, 277 Fed. 650, 655, 'there is a certain obvious injustice in giving the United States when engaged in an industrial and commercial venture, even although under war powers, superior rights over other creditors bearing like relations to insolvents.' And we think that the indicated purpose of Congress will be best carried out by construing the relevant statutes, so far as may be, with the gen-

> eral intent to preserve the substantive rights of all parties concerned as they would have existed but for federal control." *

In *Sloan Shipyards Corp.* v. *United States Shipping Board Emergency Fleet Corp.*, 258 U. S. 549, 570 (1922), it was held that debts due the Fleet Corporation were not debts due the United States.

In *Davis* v. *Pringle*, 1 F. (2d) 860 (4th Circ., 1924), aff'd 268 U. S. 315 (1925), the Circuit Court of Appeals said (p. 864):

> "* * * the contractual operations of the federal government and of the states have become so extensive and so involved with the business of private citizens that priority to the federal government and to the states, except for taxes, would operate as an oppressive hardship on other creditors of bankrupts."

In *Commonwealth* v. *Phoenix Bank*, 11 Metc. 129 (Mass., 1846), certain army pursers and recruiting officers deposited money (entrusted to them in their official capacity) in a bank which became insolvent. The government claimed priority, insisting that the deposits were debts due the United States. The Court, in an opinion by Chief Justice SHAW, held against the government, and at the very outset of its opinion declared (p. 147):

> "Claims to a preference and payment in full are not favored by any considerations of equity. The general rule is, that when several creditors are entitled to payment from a fund insufficient to satisfy the whole, they shall share in proportion. This rule

* Section 10 of the Federal Control Act (40 Stat. 451), subjected the Director General as an operator of common carriers to all applicable state laws, and expressly forbade the urging of federal control as a ground for the removal of causes from state to federal courts.

of equity may be controlled by a provision of positive law. In such case all the creditors will not be equally entitled to be paid in full, and equity must yield to the law. But in order to establish such a preference, it must be made plainly to appear that the case is within the rule of law that secures such preference."

2. *United States* v. *Guaranty Trust Co.*, 280 U. S. 478, is a precedent for inquiring into the purpose of the statute under which were carried on the operations giving rise to the claim; and the purpose of the statute there involved is sufficiently similar to that at bar to convict the Court below of error in refusing to follow it.

(a)

With the background provided by the cases cited, we come now to the National Housing Act (48 Stat. 1246), and the status under § 3466 of claims against the insolvent assigned to the United States. The assignments, of course, were taken after the United States had discharged the obligations assumed by it when, under the provisions of the Act quoted *supra*, p. 5, it had insured against loss a certain institution which had made loans to the insolvent.

A good statement of the purposes behind the National Housing Act is found in 78 Cong. Rec. (part 10) p. 11194, where Representative REILLY said:

> "Now, why should the Government go into the business of guaranteeing to any extent money loaned by bankers or other financial institutions to a citizen to repair or remodel his home, and why should the Government be interested in insuring existing mortgages and mortgages placed on homes to be built?

> The answer is that the Government is interested, deeply interested, in providing work for the 5,000,000 mechanisc [*sic*] of the country who formerly found employment in the building industry, but who are now, and have been for some time, out of work."

A similar statement as to the purposes of the bill was made by Representative Steagall at p. 11191 of the Congressional Record, a statement entitled to especial respect because it was he who introduced the bill in the House of Representatives and assumed responsibility for its passage.

(b)

The Federal Housing Administration is, it would seem, endowed with all the prerequisites of separate corporate entity, and was, in fact, listed by this Court in *Keifer & Keifer* v. *Reconstruction Finance Corp.*, 306 U. S. 381 (1939), among the corporations which Congress had recently "spawned".* Thus under § 1 of its organic act, as amended by 49 Stat. 684, § 344, the Administration may sue and be sued. It may, under § 1, appoint its own personnel and fix their tenure and compensation without regard "to other laws applicable to the employment and compensation of officers and employees of the United States". It may, under § 1, make its own contracts for rent, services and supplies "without regard to any other provisions of law governing the expenditure of public funds". It enjoys limited liability, being prohibited by § 2 (as amended by 49 Stat. 1187) from incurring liability for insurances of loans beyond $100,000,000. And it has its own seal (Executive Order No. 7058 of May 29, 1935).

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* See footnote 3, page 390, especially the first line of this note, as carried over to page 391. And see *Federal Housing Administration* v. *Burr*, 309 U. S. 242, 245 (1940).

While in the instant case the United States of America is the claimant, yet the applicability of § 3466 is affected, as we have shown, by the purpose of the statute under which the government advanced the money, and by the circumstance that the government has seen fit to limit its own participation in commercial enterprises by setting up a separate entity as the instrumentality by which such participation is brought about.

This Court recognized the capacity of the factor of separate entity to militate against a claim to priority, when it included the following *dicta* in its opinion in *United States* v. *Marxen*, 307 U. S. 200 (1939), at page 203:

> "Although an amendment of the National Housing Act authorized the Administrator to sue and be sued in any court of competent jurisdiction, state or federal, it is not necessary in answering the present certificate to determine whether by this addition the Congress intended to give the Administrator the status of a corporation or other entity distinct from the United States and by such status, to confer on or withhold from claims of the Federal Housing Administration against bankrupts the advantages of § 3466. We can deal only with a claim of the Federal Housing Administration assigned to the United States after the adjudication in bankruptcy of the obligor. It is assumed that such a claim belongs to and is made by the United States."

Another case passing upon the powers of the Federal Housing Administration and tending in effect to hold that it was not by any means to be deemed wholly identified with the sovereign, is *Federal Housing Administration* v. *Burr*, 309 U. S. 242 (1940). This Court there held that the government had no right to read into the act amending the act creating the Federal Housing Administration an exception to the suability there sanctioned (49 Stat. 722), so as to

protect the Federal Housing Administration against garnishment proceedings in a state Court. This Court apparently was of opinion that the holding reached by the Court below (which was affirmed) would not lead to such interference with the federal functions of the Administration as would make it the duty of this Court to come to its rescue.

(c)

The purpose to strengthen the borrowing power of persons desiring to carry out building programs is manifest from the debates referred to as well as from the Act itself. It is just as manifest as was the intent to rehabilitate the credit of the railroads, on which this Court dwelt at length in *United States* v. *Guaranty Trust Co., supra.* There the government had loaned sums of money to the Minneapolis & St. Louis Railroad in 1920, upon the termination of federal control. Authority to make the loans was conferred by the Transportation Act (41 Stat. 456), §§ 207, 209 and 210. There was evidence that at the time the Act was passed the credit of many carriers was seriously impaired. Priority was denied when the carrier in question later went into receivership, on the ground that to concede priority would defeat the congressional intent to aid the railroads in strengthening their credit. This Court said (280 U. S., at p. 485):

> "To have given priority to debts due the United States pursuant to Title II, would have defeated the purpose of Congress. It not only would have prevented the reestablishment of railroad credit among bankers and investors, but it would even have seriously impaired the market value of outstanding railroad securities. It would have deprived the carriers of the credit commonly enjoyed from supplymen and others; would have seriously embarrassed the car-

riers in their daily operations; and would have made necessary a great enlargement of their working capital. The provision for loans under § 210 would have been frustrated. For, carriers could ill afford voluntarily to contract new debts thereunder which would displace, *pro tanto,* their existing bonded indebtedness. The entire spirit of the Act makes clear the purpose that the rule leading to such consequences should not be applied.

Moreover, Congress evidenced unmistakably its purpose to rely, for obtaining payment of the Government's advances, upon means other than the priority provided for by § 3466."

3. The questions left open in *United States* v. *Marxen,* 307 U. S. 200, are present and determinative of the instant case. They are of public importance and certiorari should issue so that they may be answered.

(a)

There have been no decisions in this Court passing upon the applicability of § 3466 to claims under the National Housing Act assigned to the United States prior to the making of the general assignment or the filing of the petition in bankruptcy; nor are there any decisions, so far as counsel can discover, awarding priority where the government has acquired the claim by assignment from the original obligee. Of course there is no priority when the assignment to the government is shown to have been a supervening event. *United States* v. *Marxen,* 307 U. S. 200 (1939). But in this case this Court said that the United States "has priority, *if at all,* by virtue of the general provisions of § 3466, as recognized by § 64(b) (7) of the Bankruptcy Act." (Italics

ours.) The Court then added, by way of *dictum* to be sure, some cautionary observations on the necessity of heeding *the purpose of the statute* under which the government's claim arose. The Court said (pp. 206-207):

> "But this principle of construction is subject to the limitation that the generality of the language of the section is restricted by the purpose to grant priority to the United States, only, *and by legislative intention, as shown by other statutes.* Consequently priority was refused to corporations wholly owned by the United States * and to the Director General of Railroads because § 10 of the Federal Control Act manifested an intention that the carriers under federal control should be treated as before their transfer to federal operation.† The United States itself when it sought priority for its loans under the Transportation Act was denied the benefits of § 3466 because the intention to build up the credit standing of the railroads was inconsistent with the claimed priority."‡ (Italics ours.)

We suggest (we cannot, of course, be dogmatic) that this language was inserted in the opinion to intimate the Court's unwillingness to sanction a claimed priority where to do so would defeat the purpose of the National Housing Act.

(b)

We find nothing hostile to the foregoing in *United States* v. *Summerlin*, 310 U. S. 414 (1940). This Court there held that a debt owing to the Federal Housing Administrator under the National Housing Act was a debt on which the United States itself had the right to sue and hence to be freed of such impediments as might be imposed by state

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* *Sloan Shipyards* v. *U. S. Fleet Corp.*, 258 U. S. 549, 570. Even though private parties might have participated in stock ownership under the law. See p. 565.

† *Mellon* v. *Michigan Trust Co., supra*, 271 U. S., at p. 240.

‡ *United States* v. *Guaranty Trust Co.*, 280 U. S. 478, 485-486.

statutes of limitations. From this the Court in *Korman* v. *Federal Housing Administration,* 113 F. (2d) 743 (App. D. C., 1940), inferred that § 3466 was applicable. But in claims arising out of federal control of railroads an exactly similar ruling was made as to state statutes of limitations in *Dupont de Nemours & Co.* v. *Davis,* 264 U. S. 456, 462 (1924), and yet this Court later refused to extend § 3466 to the Director General of Railroads in *Mellon* v. *Michigan Trust Co.,* 271 U. S. 236 (1926), *ante,* page 12.

(c)

Another argument against holding § 3466 to apply is that, since the banks have no right to appeal to the government to make good on its insurance contracts until the borrower has been in default 60 days (Regulation 15, printed at R., 21), and since the government cannot invoke § 3466 if the debtor has already made a general assignment before the government acquired the claim, the effective operation of § 3466 in favor of the government is dependent upon the purely speculative possibility that the government took its assignment during the narrow interval of time between a sixty-day default and the debtor's general assignment or bankruptcy.

Actually the regulations encourage banks to wait as long as a year before appealing to the government; or if 10% has been paid on account, the banks may wait still longer (R., 21). Thus the hazard is great that the debtor will make a general assignment or be thrown into bankruptcy before the government is called in (and hence before the government could receive an assignment from the banks). A priority dependent on split-second timing is a phenomenon unworthy of judicial recognition.

Conclusion.

The extension of U. S. R. S. § 3466 to claims upon commercial paper insured under the National Housing Act and assigned to the government after it has had to make good losses sustained by the holder, has little to commend it to a tribunal endowed with a capacity to appreciate realities. We have seen (*ante*, pp. 14-15) that the object of the National Housing Act was to aid in combatting unemployment by encouraging the employment of mechanics affiliated with the building industry. No contractor would risk contracting with a home owner, known to be operating with borrowed capital, if he knew that, upon the home owner's failure to meet his obligations, the contractor could not hope to share in the insolvent estate but would have to sit idly by and see the government, with a capital claim and not a mere claim for taxes, take all the assets. We should not impute to Congress the ineptitude of aiding building enterprises with one hand and inflicting on them likelihood of loss with the other. Moreover, the result below, by causing losses (and even possible bankruptcy) to builders and contractors, would actually tend to increase the very unemployment which Congress so studiously aimed to diminish. *United States* v. *Guaranty Trust Co., supra*, p. 17, is ample authority for rejecting the literal application of § 3466 in the interest of avoiding unjust or absurd results. We urge the Court to acknowledge the force of its analogy.

The Petition for Certiorari should be granted.

January 18, 1941.

Respectfully submitted,

WILLIAM C. CHANLER,
Corporation Counsel,
Attorney for Petitioner.

PAXTON BLAIR,
SOL CHARLES LEVINE,
CHARLES H. BIRDSALL,
of Counsel.